



McKesson Corporation (MCK)

Updated May 10th, 2023, by Josh Arnold

Key Metrics

Current Price:	\$389	5 Year CAGR Estimate:	5.0%	Market Cap:	\$53 B
Fair Value Price:	\$345	5 Year Growth Estimate:	7.0%	Ex-Dividend Date:	05/31/23
% Fair Value:	113%	5 Year Valuation Multiple Estimate:	-2.4%	Dividend Payment Date:	07/03/23
Dividend Yield:	0.6%	5 Year Price Target	\$484	Years Of Dividend Growth:	15
Dividend Risk Score:	A	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

McKesson Corporation traces its lineage to 1833 when its founders began to offer wholesale chemicals and pharmaceuticals in New York City. In the 189 years since, McKesson has grown into a powerhouse in the pharmaceutical and medical distribution industry and today, generates about \$290 billion in annual revenue and trades with a \$53 billion market capitalization.

McKesson posted fourth quarter and full-year earnings on May 8th, 2023, and results were ahead of expectations on both revenue and profits. The company posted adjusted earnings-per-share of \$7.19 for the quarter, which was six cents ahead of expectations. Revenue was up 4.3% year-over-year to \$68.9 billion, and beat estimates by nearly a billion dollars.

US Pharma revenue was up 15% year-over-year to \$61.7 billion, due to increased volume of specialty products and market growth. The company said it expects to see 5% to 7% growth in US Pharma, and 11% to 12% growth in prescription technology solutions, as well as 10% to 12% in medical-surgical solutions.

McKesson ended the quarter with \$4.7 billion in cash and equivalents, up by a third from the year-ago period. In addition, management guided for \$26.10 to \$26.90 in earnings-per-share for this year, and we've set our initial estimate at \$26.55 accordingly.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$8.35	\$11.11	\$9.84	\$11.61	\$12.62	\$13.57	\$14.95	\$17.21	\$23.69	\$25.94	\$26.55	\$37.24
DPS	\$0.92	\$0.96	\$1.08	\$1.12	\$1.30	\$1.51	\$1.62	\$1.67	\$1.83	\$2.09	\$2.16	\$3.03
Shares¹	231	232	225	211	202	191	173	158	145	136	133	125

McKesson's earnings-per-share history is quite robust, having grown nearly every year in the past decade. Indeed, McKesson has managed to average more than 10% earnings-per-share growth annually over this time frame through organic revenue growth and many acquisitions. We do not believe that sort of growth is likely for the longer term as McKesson has grown much larger. As a result, it seems to have neared a plateau on operating margins and revenue growth, but we do still see 7% annual earnings-per-share growth as sustainable moving forward.

McKesson can achieve this result largely via revenue gains, as it continues to acquire growth in bolt-on acquisitions with companies that supplement its current offerings, a strategy that is unlikely to change. Margins have been flat for some time, so we expect that will continue.

The buyback should continue to meaningfully reduce the float over time, which we see as a key driver of earnings-per-share growth. We remain somewhat cautious due to an increasingly hostile regulatory environment for drug wholesalers like McKesson. In addition, constant pressure on pricing from regulators, as well as strong generic conversion are headwinds. However, recent results have been quite supportive of long-term growth, and commentary from management to start 2023 has been very bullish.

¹ Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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The dividend has never been a priority for McKesson and that is not likely to change anytime soon. We see the payout rising from today's \$2.16 to \$3.03 in five years, but the dividend remains just a small fraction of earnings, and the yield is low as a result.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	16.8	17.9	20.1	14.1	12.0	9.7	9.3	9.4	9.3	14.1	14.7	13.0
Avg. Yld.	0.7%	0.5%	0.5%	0.7%	0.5%	1.1%	1.2%	1.0%	0.8%	0.6%	0.6%	0.6%

The stock's price-to-earnings ratio has ebbed and flowed in the past decade but today, at 14.7 times earnings, it appears to be overvalued relative to its historical norm. We see fair value as 13 times earnings and thus, McKesson looks overvalued at the moment. This could provide a headwind to total returns over the next five years if the stock's valuation reverts to more normalized levels. The yield should remain about where it is for the foreseeable future, and we note McKesson is not a high-income stock.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	11%	9%	11%	10%	10%	11%	11%	10%	8%	8%	8%	8%

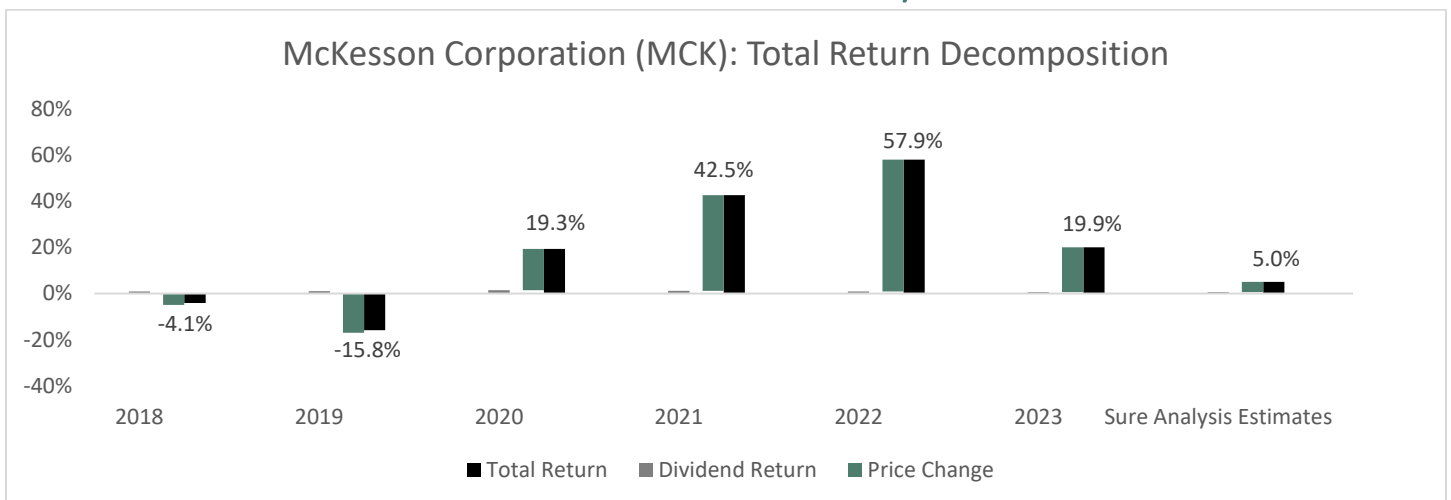
The payout ratio will remain very low barring a material strategic shift, which we are not forecasting. Instead, McKesson will almost certainly continue to boost earnings-per-share by reducing the float.

Its competitive advantage is in its willingness to adapt and shift to the changing needs of its customers, its willingness to buy growth and its immense scale, which affords purchasing power. In addition, the company is constantly reevaluating its portfolio, divesting non-core assets, and using proceeds to acquire future growth. McKesson held up well during the COVID crisis given its product assortment that offers healthcare consumers things they need, and not discretionary items.

Final Thoughts & Recommendation

McKesson offers a strong growth outlook, a robust share repurchase program and a valuation that is ahead of our view of fair value. We are forecasting 5% annual total returns going forward, consisting of the current 0.6% yield, 7% earnings-per-share growth and a 2.4% headwind from a contracting valuation. We reiterate the stock at a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue (\$B)	122.2	137.4	179.0	190.9	198.5	208.4	214.3	231.1	238.2	264.0
Gross Profit	6,881	8,352	11,411	11,416	11,271	11,184	11,754	12,023	12,148	13,130
Gross Margin	5.6%	6.1%	6.4%	6.0%	5.7%	5.4%	5.5%	5.2%	5.1%	5.0%
SG&A Exp.	4,110	5,388	7,901	7,379	7,447	8,138	8,403	9,168	8,849	10,537
D&A Exp.	581	735	1,017	885	910	951	949	922	887	760
Operating Profit	2,338	2,507	3,118	3,645	3,483	2,921	3,280	2,759	3,299	2,593
Operating Margin	1.9%	1.8%	1.7%	1.9%	1.8%	1.4%	1.5%	1.2%	1.4%	1.0%
Net Profit	1,338	1,263	1,476	2,258	5,070	67	34	900	(4,539)	1,114
Net Margin	1.1%	0.9%	0.8%	1.2%	2.6%	0.0%	0.0%	0.4%	-1.9%	0.4%
Free Cash Flow	2,083	2,717	2,567	2,995	4,182	3,765	3,479	3,868	3,901	3,899
Income Tax	587	757	815	908	1,614	(53)	356	18	(695)	636

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	34,786	51,759	53,870	56,523	60,969	60,381	59,672	61,247	65,015	63,298
Cash & Equivalents	2,456	4,193	5,341	4,048	2,783	2,672	2,981	4,015	6,278	3,532
Acc. Receivable	8,683	12,169	13,117	14,519	14,602	14,349	14,941	17,201	17,106	16,438
Inventories	10,335	12,986	14,296	15,335	15,278	16,310	16,709	16,734	19,246	18,702
Goodwill & Int.	8,675	14,798	13,258	12,807	14,251	15,026	13,047	12,516	12,371	11,510
Total Liabilities	27,716	41,441	45,785	47,515	49,696	50,324	51,385	55,938	64,840	65,090
Accounts Payable	16,108	21,128	25,166	28,585	31,022	32,177	33,853	37,195	38,975	38,086
Long-Term Debt	4,873	10,594	9,844	8,114	8,545	7,880	7,595	7,387	7,148	5,879
Total Equity	7,070	8,522	8,001	8,924	11,095	9,804	8,094	5,092	(21)	(2,272)
LTD/E Ratio	0.69	1.24	1.23	0.91	0.77	0.80	0.94	1.45	---	-2.59

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2021
Return on Assets	3.9%	2.9%	2.8%	4.1%	8.6%	0.1%	0.1%	1.5%	-7.2%	1.7%
Return on Equity	19.3%	16.2%	17.9%	26.7%	50.7%	0.6%	0.4%	13.7%	-179%	---
ROIC	11.8%	7.7%	7.6%	12.9%	27.4%	0.4%	0.2%	6.3%	-45.3%	17.6%
Shares Out.	227	231	232	225	211	202	191	173	158	154
Revenue/Share	511.28	589.67	761.89	819.24	890.28	996.92	1,087.9	1,269.5	1,483.4	1,713.0
FCF/Share	8.72	11.66	10.92	12.85	18.75	18.01	17.66	21.25	24.29	25.30

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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